Omani banking industry competitive, matured


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The banking sector in the Sultanate has evolved immensely over the past decade and become increasingly more competitive, with an assortment of commercial banks and banks which now exclusively focus on Islamic finance.

It is indisputable from the data and empirical evidence that this is an industry which has "matured". Yet investors simply continue to focus on metrics that would only be highly relevant in a macroeconomic environment where the banking industry is either (i) just beginning to get its feet on the ground, or (ii) is situated in an unstable political climate characterised by turmoil.

There is an undeniable impact of oil prices on bank profitability in MENA countries that largely depend on oil production (there is academic evidence from the IMF which confirms this), and Oman is certainly not shielded from it; net oil revenues constitute on average 70 per cent of the budgeted revenues (although they have been declining over the last 5 years and are expected to further decline to around 66.4 per cent in 2015 with diversification efforts already under way).

The good news however is Oman pegged government spending at RO 14.1 billion for 2015, up by about 4.5 per cent compared with 2014.

The sustained spending will allow Oman to press forward with major projects, including a $15 billion national railway network and major expansion projects at airports in Muscat and the southern city of Salalah.

This has been confirmed by Darwish bin Ismaeel bin Ali al Balushi, Oman's Minister Responsible for Financial Affairs saying the country has no specific plans to reduce state spending this year, despite the plunge in oil prices to well below the level assumed in its government budget.

According to Al Balushi, "there are no specific plans to cut public expenditure at this time. We are observing the situation closely and the oil prices are still fluctuating".

The decline in oil prices is a topic that has already received enough media coverage, and the truth of the matter is there is really not much value going into a detailed view on why we expect oil prices to revert back to "normalised" levels.

This is due to the following reasons: (i) we are not in the business of forecasting where oil prices will end up over the next couple years; (ii) we profess upfront we do not understand what "normalised levels" really mean; and (iii) most financial "pundits" who claim to understand these and put a price target on where oil will ultimately end up near-term have been proven dead wrong — thus, we believe it is meaningless to speculate on the actual level unless we are in the company of highly ranked officials who intricately understand supply and demand dynamics of the commodity.

The only bet we are placing here is that current levels are unsustainable and the price of oil will move higher to "correct" itself over the next 24 months. We have seen this story play out before and this "correction" assumption is one of the central macro tenets of our thesis.

We believe history will repeat itself, prices will normalise, and as a rising tide lifts all ships, the Muscat Securities Market and GCC's other market indices which have been hammered recently will rebound, with particularly strong growth in the banking sector.

While on the subject of oil price, it is worthwhile to spend a few lines here discussing Oman's projected GDP growth in 2015. According to the just-released 2015 budget, the national economy grew at an estimated real growth rate of 4 per cent in 2013 and 4.4 per cent in 2014.

In 2015, the targeted rate of growth is 5 per cent. Good GDP growth in Oman along with favourable monetary and fiscal policies has had a positive impact on the growth and performance of the commercial banks in Oman. The balance sheets of the banks have strengthened, further supported by growth in credit and deposit. Lending to the private sector was fairly balanced between corporate and retail sectors.

The Omani banking system will remain primarily deposit-funded and liquid over the outlook period. We expect increased revenue from credit growth and stable provisioning requirements to offset pressure on profits from reduced interest rate margins and from rising operating expenses, as banks continue to build their Islamic banking franchises.

As far as other industries are concerned, corporate Earnings have been forecast to continue to grow at mid-single digits during 2015 amidst the Government proposal to increase gas prices for Industries. Per the 2015 budget, "the economic growth depends on the growth of the non-oil activities, strong local demand and higher oil production".

There has been a strong focus on diversification away from oil and gas related activities. The government expects non-oil activities will grow at a rate of 5.5 per cent in 2015 and the concentration will mainly be on the construction, electricity, water, trade activities and services of public administration, defence and transfer industries.

However, this diversification process does not take place overnight. We believe that the bleak short-term outlook as it relates to profitability and loan growth may lead to continued volatility over the next 3-4 (even 6) months and as a result continue to spook investors further. And therein lies the opportunity to continue to accumulate more of this asset at a wonderful price as it continues to grow its book value.

DISLCAIMER: The views expressed in the article are part of a study conducted by the author duo.